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No. 108

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

MILL RIDGE COAL COMPANY, *Petitioner*,

v.

GEORGE D. PATTERSON, DISTRICT DIRECTOR OF INTERNAL REVENUE, *Respondent*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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REPLY BRIEF OF PETITIONER

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REPLY BRIEF OF PETITIONER

The Government's brief in opposition gives compelling evidence of the need of adjudication of this case by this Court. For that brief centers around several legal premises, all of which are highly controversial and all of which deal with matters of substantial importance.

1. Libson Shops

(a) The Government asserts, at page 4, that this case, involving a single corporate taxpayer, "is controlled by the rationale of this Court's decision in *Lib-*

son Shops, Inc. v. *Kohler*, 353 U.S. 382". But this Court indicated to the contrary, 353 U.S. 390, Footnote 9; the Tax Court has squarely held to the contrary, *British Motor Car Distributors, Ltd.*, 31 T.C. 437; and the legal commentators have stated the contrary, *e.g.*, Levine & Petta, *"Libson Shops Applied to a Single Corporate Taxpayer"*, 36 *Taxes* 562 (1958); 8 *Tax Fortnighter* No. 6 (March 18, 1959); and 9 *Jour. Tax.* 219 (Oct. 1958).

(b) In response to petitioner's contention that the Court below erroneously applied *Libson Shops* to the 1954 Code, the Government not only does not deny but affirmatively asserts, at page 6, that the "continuity of business enterprise" test of *Libson Shops* applies to Section 172 of the 1954 Code. But this Court indicated that that test has been supplanted by Sections 381 and 382 of the 1954 Code, 353 U.S. 385, Footnote 2; the Treasury Department itself apparently stated that it would not seek to apply *Libson Shops* to the 1954 Code, T.I.R. No. 89, August 25, 1958; 9 *Jour. Tax.* 219; and the legal writers have commented vigorously that *Libson Shops* does not apply to the 1954 Code, see Sinrich, *"Libson Shops—An Argument Against Its Application Under the 1954 Code"*, 13 *Tax. L. Rev.* 167 (1958); 9 *Jour. Tax.* 219; see also, Graichin, *"The Net Operating Loss"*, 16 *N.Y.U. Inst. Fed. Tax.* 865, 873-4 (1958).

(c) Any belief that these two problems are esoteric or minor (either in a legal or an economic sense) may be quickly dispelled by recalling the events that transpired during the 1958 annual meeting of the Section of Taxation of the American Bar Association. Following the decision of this Court in *Libson Shops* in May, 1957, the Internal Revenue Service commenced

studying "the problem of how to administer the continuity of business test as to pending cases under the 1939 Code and whether the continuity of business principle applies under the 1954 Code in view of the enactment of §§ 381 and 382". (A.B.A., Section of Taxation, *Bulletin*, p. 25, April, 1958). Ample testimony as to the widespread interest in these problems was given by the Chief Counsel of the Internal Revenue Service when he stated that he had "long since lost count of the number of lawyers who have complained to me about that delay [in issuing a policy statement about *Libson Shops*]". (A.B.A., Section of Taxation, *Bulletin*, p. 9, October 1958). Prior to August 23, 1958, the Service had taken the position that it could not issue a statement of policy in advance of the promulgation of regulations under Sections 381 and 382. At the session of the Tax Section held August 23, however, discussion of these problems consumed most of the day, and a legislative proposal to amend Section 172 expressly to preclude application of *Libson Shops* under the 1954 Code was approved. Shortly thereafter, at that session, the Chief Counsel of the Internal Revenue Service announced the position of the Service (T.I.R. No. 89), even though the regulations under Sections 381 and 382 had not then been proposed (in fact, they have not been proposed as of this date). After this announcement, a motion to reconsider the recommendation of the legislative proposal was adopted, and the following afternoon, the legislative proposal was again discussed, and was again approved. See 9 *Jour. Tax.* 219.

It is difficult to believe that the leading tax practitioners of this country—and, apparently, the Service itself—would spend so much time and effort on these

problems if, as the Government states (at page 9), they are of "continually diminishing importance".

2. Section 172

The Government contends that Section 172 of the 1954 Code must be construed in light of *Libson Shops* (pages 7-8; see also, last sentence of page 6). Thus, the Government argues that, by itself, Section 172 prohibits the use of carryovers if there is a change in business only by a single corporate taxpayer. If this is true, we have the strange anomaly of Section 382(a), termed "Special Limitations on Net Operating Loss Carryovers", being considerably broader that Section 172, the very section it (Section 382) is supposed to limit. For if the Government's theory is correct, a corporation that changed business without a change of stock ownership could not claim the deduction under 172, even though the clear implication of Section 382(a) is that the deduction should be permitted. It seems clear that, in the light of Section 382(a), the business continuity test of *Libson Shops* is not a part of Section 172; otherwise Section 382(a) is meaningless.

Moreover, the word "taxpayer" about which the controversy in *Libson Shops* centered does not appear in Section 172 of the 1954 Code. The Government argues (page 6) that *Libson Shops* did not turn on the meaning of the word "taxpayer" in Section 122 of the 1939 Code. However, in *Libson Shops* this Court specifically said. "The controversy enters on the meaning of 'the taxpayer'. The contentions of the parties require us to decide whether it can be said that petitioner, a combination of 16 sales businesses is 'the taxpayer' having the pre-merger losses of three of those businesses." (353 U.S. at 385). This Court, itself, pointed out that the words "the taxpayer" do not ap-

pear in the carryover provisions of the 1954 Code indicating that this omission may well be significant under the 1954 Code. 353 U.S. 927, Footnote 2.

The Government admits (Footnote 2, page 7) that *Libson Shops* does not apply to mergers, liquidations or reorganizations under the 1954 Code. This admission means that under the Government's view a successor corporation in a merger may use a predecessor's loss carryover incurred in a different business while a single corporate taxpayer, even in the absence of a change of stock ownership, cannot use its own loss carryover incurred in a different business. Obviously, such a result was not intended by Congress in enacting the 1954 Code. Nor does the petitioner contend that there is a hiatus between the 1939 Code and the 1954 Code with respect to a change of business by a single corporate taxpayer. It has never been held in any case decided under the 1939 Code, including *Libson Shops*, or provided in the 1939 Code or in any regulations thereunder that a single corporate taxpayer could not change its business and continue to use its own loss carryover. It was not until the enactment of Section 382(a) of the 1954 Code that such a concept was introduced into the tax laws and Section 382(a) is not applicable to this case.

3. Section 269

With respect to the applicability of Section 269 of the 1954 Code to this case, the Government asserts, at pages 8-9, that "The only question is whether the fact that the carryover deduction is taken by the acquired corporation itself, with the acquiring 'persons' securing the 'benefit' only indirectly, precludes the application of the section. In our view it clearly does not." The Tax Court, however, in *British Motor Car Dis-*

tributors, Ltd., supra, has squarely held to the contrary: "While its new stockholders may gain some tax advantage as stockholders because of petitioner's use of its losses, it is still the petitioner and not the stockholders who seek to claim the benefit in the case before us. *We think the possible benefit which may flow to the stockholders is too tenuous a benefit to bring Section 129 into play.*" (Our emphasis). It is significant also that the regulations promulgated under Section 129 of the 1939 Code do not suggest such an interpretation. Regs. 118, Sec. 39.129-3 (b).

The Government attempts to buttress its argument by claiming that "While the deduction itself can only be taken by the corporation, it is the new owners who will ultimately secure the benefit of the deduction . . .". Presumably this assertion is based on the conception that the corporation will be successful and pay dividends or be liquidated at a profit. Of course, there is no assurance that the petitioner will be successful; in fact the mortality rates for small corporations would indicate that the chances are to the contrary. Moreover, this argument of the Government is premised upon disregarding the fact that the petitioner is a corporate taxable entity separate from its stockholders and the benefit of the deduction in question is obtained by the corporation and not its stockholders. As stated at page 15-16 of the petition, the doctrine of *Higgins* v. *Smith*, 308 U.S. 473 (1939), on which the decision in *Coastal Oil Storage Co.* v. *Commissioner*, 242 F. 2d 396 (4th Cir. 1957), was based, is not applicable to this case.

The position of the Government that a stockholder of a corporation, for purposes of Section 269, obtains the benefit of all the tax savings of the corporation

leads, without extending logic unduly, to the unique proposition that anyone who forms a corporation to save taxes (and it is undoubtedly for tax purposes that thousands of corporations are organized each year) runs afoul of Section 269. Thus, if the Government's interpretation of Section 269(a)(1) is correct, every incorporation of a partnership or sole proprietorship to place the earnings thereof in a lower tax bracket would come within the prohibitions of Section 269(a)(1) because the partners or sole proprietor would acquire control of a corporation for the purpose of securing a tax benefit (the surtax exemption to which a corporation is entitled) which the partners or sole proprietor would not otherwise enjoy. Congress, we submit, never contemplated such an interpretation of the law.

4. National Importance of This Case

In our petition, we pointed out that this case deals not only with important and controversial matters of law but also with matters of law that vitally affect a large number of taxpayers. Another gauge to the soundness of these contentions is the fact that as of this date, almost five years after the enactment of the 1954 Code and more than two years after the decision of this Court in *Libson Shops*, the Department of Treasury has yet to promulgate or even propose regulations under Sections 269, 381 and 382. The regulations issued under Section 172 do not suggest in any way that there is a business continuity test in applying Section 172. Various inferences may be drawn from the delay in issuing regulations under Sections 381, 382, and 269, but it seems reasonable to conclude that the primary reason for that delay is that the Department of Treasury itself is not yet certain of the official

position that it will take with respect to the interpretation of these sections. If such be the case, the issues in this case are certainly not as clear and non-controversial as the Government's brief seeks to indicate.

The Government suggests (page 9) that this case is of diminishing importance because an instance such as the one involved in this case in which there is both a change of stock ownership and a change of business is now covered by Section 382(a) of the 1954 Code. But this statement ignores the fact that the Government seeks to sustain the decision in this case in the Court below solely on the basis of a change of business, relying on *Libson Shops* which did not involve a change of stock ownership. This is clearly a question of continuing and vital importance under the 1954 Code as evidenced by the concern of the leading tax practitioners in the nation. See Winton, "*Loss Carryovers: courts grope toward judicial doctrine of business continuity*", 11 *Jour. Tax*, 76 (Aug. 1959).

The Government also seeks to sustain the decision below on its interpretation of Section 269(a)(1) of the 1954 Code which is in direct and irreconcilable conflict with decisions of the Tax Court. The Tax Court decision in *British Motor Car Distributors, Ltd.* was reviewed by the entire Tax Court, and therefore, will be followed by the Tax Court despite conflicts with courts of appeal or even reversals by courts of appeal until the issue is resolved by this Court. In *Arthur L. Lawrence*, 27 T.C. 713 (1957) the Tax Court in an opinion reviewed by the entire court without a dissent stated that since it was a court of national jurisdiction it would "to avoid confusion . . . follow its own honest beliefs until the Supreme Court decides the point". 27 T.C. at 716-7, 719-20.

As stated in the *Lawrence* case the Commissioner of Internal Revenue has the duty of administering the taxing statutes uniformly throughout the United States. The Tax Court has a similar duty of uniformly interpreting the taxing statutes. These two national agencies are in direct conflict over the interpretation of Sections 172 and 269(a)(1) of the 1954 Code and this conflict can only be resolved by the Congress or this Court. There appears to be no indication that Congress will resolve this conflict. In view of the obvious importance of net operating loss carryovers to taxpayers and to the Government (see pages 9 and 10 of the petition), this is clearly a case of national importance which should be decided by this Court.

We respectfully urge that the petition for a writ of certiorari be granted.

Respectfully submitted,

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PETITION FOR REHEARING OF THE DENIAL OF THE PETITION FOR A WRIT OF CERTIORARI

To the

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PETITION FOR REHEARING OF THE DENIAL OF THE PETITION FOR A WRIT OF CERTIORARI

To the

United States Court of Appeals for the Fifth Circuit

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Pursuant to the provisions of Paragraph 2 of Rule 58 of the rules of this Court, Petitioner requests a rehearing of this Court's denial of the petition for a writ of certiorari in this case.

The order denying the petition for a writ of certiorari was dated October 12, 1959. We have since been informed that *British Motor Car Distributors, Ltd.,*

31 T.C. 437 (1958) has been set for an oral hearing on November 12, 1959 before the Court of Appeals for the Ninth Circuit. We believe that a decision will be rendered by the Court of Appeals for the Ninth Circuit within several months after the oral hearing.

The decision of the Tax Court in the *British Motor Car* case is directly in conflict with both grounds of the decision of the Court of Appeals for the Fifth Circuit in the instant case. This is conceded by the Government at page 9 of its brief in opposition to the instant petition for a writ of certiorari. In the Government's brief before the Court of Appeals in the *British Motor Car* case the Government stated that, "The case at bar [*British Motor Car*] is in all material respects indistinguishable from *Mill Ridge Coal Co.* v. *Patterson*, 264 F. 2d 713 (C.A. 5th), petition for certiorari filed June 10, 1959, and it is the position of the Government that the result should be the same." If, in the *British Motor Car* case, the Court of Appeals should affirm the decision of the Tax Court and a petition for writ of certiorari is subsequently filed by the Government, then this petition for rehearing should be granted so that both the *Mill Ridge* and *British Motor Car* cases can be considered by this Court at the same time.

The principles of federal income taxation involved in the *Mill Ridge* and *British Motor Car* cases are of broad application and of national importance and should be applied uniformly to all taxpayers. In *United States* v. *Ohio Power Company*, 353 U.S. 98 (No. 312 Oct. Term, 1955, decided April 1, 1957) this Court in vacating an order denying a petition for rehearing after successive petitions for rehearing had been denied, stated that "The interest in finality of

litigation must yield where the interest of justice would make unfair the strict application of our rules." 353 U.S. at page 99. This principle is particularly applicable in tax cases where the United States has an obligation to treat all taxpayers uniformly.

Because of the twenty-five day period provided by Rule 58 within which a petition for rehearing must be filed, petitioner is unable to delay filing this petition for rehearing until after a decision is rendered in the *British Motor Car* case. Accordingly, Petitioner requests that this Court hold this petition for rehearing in the breast of the Court and further requests that this petition for rehearing be granted at such time as a petition for a writ of certiorari may be filed in the *British Motor Car* case.

Respectfully submitted,

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Certificate Pursuant to Rule 58-2

The undersigned counsel for the Petitioner herein certifies that this petition for rehearing is presented in good faith and not for delay, and that the foregoing petition is restricted to the grounds above specified.

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